A.I.D. Program and Operations Assessment Report No. 1

A.I.D. Economic Policy Reform Programs in Africa
A Synthesis of Findings From Six Evaluations

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by

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FOREWORD

Over the years, many African countries developed an elaborate set of market controls and regulations. Each control might have been designed for a seemingly worthwhile purpose: to keep prices reasonable for the poor, to protect local firms from ruinous foreign competition, to ensure readily available supplies, or to prevent exploitation. Whatever the reason, over time the government and private firms made investments and designed their business operations around these controls and regulations. Often the controls were designed as a short-term measure to protect farmers, businesses, and consumers from changes in international prices. Over the years, however, many of the short-term controls became permanent and increasingly inappropriate as international prices continued to change. By the mid-1980s most African countries were clearly seeing the downside of controls: inadequate investment, inefficient industries, declining crop sales, shortages of goods, and a stagnant or declining gross national product (GNP). It became clear to these governments that reform of inappropriate economic policies was essential if they were ever to achieve sustainable economic development.

Since FY 1985, the African Economic Policy Reform Program (AEPRP) has become the centerpiece of A.I.D.'s efforts to help African governments restructure their economies. From FY 1985 through FY 1990, A.I.D.

committed $308.8 million to 19 countries under the AEPRP. Since many of the policy reform programs have been operating for only a few years, it is still too early to make a definitive judgment on their long-run development impact. Nevertheless, it is possible to examine some of the early reform programs that were implemented at least 2 or 3 years ago to assess the preliminary impacts and the direction of reform efforts.

During 1989 and 1990, A.I.D.'s Center for Development Information and Evaluation and the Africa Bureau jointly evaluated A.I.D.-supported reform programs in six African countries: Mali, The Gambia, Senegal, Cameroon, Malawi, and Uganda. These country case studies provide an assessment of the impact and effectiveness of A.I.D.'s policy reform efforts. In addition to providing a review of progress to date, the evaluations provide ideas and insights on how to improve the developmental impact of future policy reform programs. This Synthesis includes four sections:

1. A brief introduction describing the economic problems that gave rise to the reforms, the context for A.I.D.-supported policy reforms, and a brief listing of the reforms.

2. An examination of the individual country reform programs: the economic problems, the policy reform objectives, the results of the reforms, and, finally, the factors that influenced the performance of the policy reforms.

3. An examination of key reform objectives and the common findings concerning reform results that emerge from the different country assessments.

4. Operational findings and lessons useful for A.I.D. managers in planning future policy reform programs.

Given the significant worldwide economic and political changes of the last few years, economic reform will continue to hold prominence in the agendas of donors and developing country governments. Many countries will need assistance in restructuring their economies. This synthesis of the findings, conclusions, and lessons learned from the six evaluations of A.I.D. economic policy reform programs in Africa can help policymakers in their efforts to support future programs.

Those interested in more information about the six country programs can obtain copies of the evaluation reports listed at the end of this study.

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SUMMARY

Introduction

The worldwide recession of 1981-1983 was the most severe in nearly 50 years. African countries faced a sharply changed economic environment: the favorable price and demand relationships of the 1960s and 1970s disappeared. Since their independence, most African countries had developed an array of regulations, controls, and subsidies whose inappropriateness was made painfully apparent during the period of economic decline. International donor organizations, as well as the African governments, realized that these policies had to be changed. Moreover, the countries needed to institute a package of incentives to restructure their economies to deal effectively with the new economic environment.

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Summary of the Reform Programs

The reform programs covered a broad range of sectors and subsectors. While the areas of reform are not directly comparable between countries, they all involve the introduction of change in key economic policies in sectors critical to economic growth. The individual country reforms included the following elements:

In Cameroon and Malawi, the reforms liberalized the fertilizer market by providing fertilizer on a timely basis and at a reasonable cost to farmers. In Cameroon this meant moving toward a private, competitive fertilizer market with a phase-down of government subsidies and controls. In Malawi the program was designed to reduce the fertilizer subsidy and reduce foreign exchange costs by importing a higher value fertilizer.

In Mali the reforms moved the Government away from its centralized statist economic approach to a less regulated economy with an improved private sector climate and improved public sector efficiency.

In Senegal the reforms were designed to increase the competitiveness of the private industrial sector and to improve the efficiency and equity of the tax system.

The Gambia program was designed to encourage greater private sector involvement in agricultural marketing and investment, while sharply reducing government regulation of agricultural and financial markets.

In Uganda reforms focused on the foreign exchange system and were designed to encourage private sector nontraditional exports.

Major Evaluation Findings

The six A.I.D.-supported policy reform programs were generally successful, though in most cases the reforms took longer than expected and many objectives were not fully achieved at the time of the evaluations. The main findings include the following:

The removal of price and market controls generally had an immediate and positive impact as prices declined and goods became more readily available. The only disappointment was the hesitancy and reluctance of the private sector, in some cases, to take full advantage of new investment and market opportunities. The uncertain political environment and uncertainty surrounding the sustainability of the reforms put a damper on long-term investments.

The elimination of subsidies and industrial protection spurred productive efficiency but required some painful adjustments for firms that had previously been subsidized or protected from competition.

Although the removal of import and export controls helped improve efficiency, it was not always matched by a reduction in government bureaucratic and administrative delays (e.g., ministry approvals, clearances, permits).

The elimination of monopolies held by state-owned enterprises opened markets and allowed the private sector to compete and deliver goods at a much lower cost. The problem of linked markets (where the government still applied controls) and inadequate business infrastructure hampered the effectiveness of the reforms.

Tax reforms to improve economic incentives and the efficiency of tax collection and civil service reforms appear promising though results are uneven. The reforms have only been in place a short time, and it is probably too early to determine major and sustainable results.

Programs that developed the internal policy reform capacity of the host country helped build long-run policy reform sustainability. To build that capacity, the most successful A.I.D. programs provided policy-based technical assistance.

Contrary to previous views that policy-based nonproject assistance was an easy way to provide assistance, with minimal staff burden, the evaluations found that policy reform programs require large analytical staff input from both A.I.D. and the host government.

Policy reform involves a highly complex set of political, economic, and social changes with winners and losers in both the public and private sectors. Those who stand to lose will oppose the adoption of the changes and during implementation will work directly or indirectly to negate the reforms. Thus, reforms are not just a set of technical plans to be processed mechanically. A.I.D. must carefully consider the costs of adjustment and be prepared to analyze thoroughly and deal creatively with the sociopolitical effects of the changes it is supporting.

Lessons Learned

The major lessons that have thus far emerged from the evaluations are as follows:

A.I.D. should put its time and energy into the development of analytically sound reform programs and worry much less about the type or form of assistance it provides. In the six policy reform programs, A.I.D. provided resources through a variety of mechanismsþcash transfers, commodity import programs (CIPs), and PL 480 agreements. The impact of the reforms was dependent on the host government's ability to successfully adopt and implement the new policies, not on the form of A.I.D. assistance. There was little difference between the reforms in Uganda (with a CIP and PL 480) and those in the other countries that used cash transfers.

The development of the host country's internal policy analysis capacity is important for long-run sustainability of policy reform. All the programs included technical assistance, designed to improve the host government's capacity to develop and implement policy reform programs. But in some countries the technical assistance included in the original program was never provided. The evaluations found that policy reform is a continuing process requiring constant monitoring and adjustment as the effects of each new policy emerge. The developing countries needed to develop their own internal capacity to analyze and to set their own policy reform agenda; A.I.D. technical assistance can help develop that capacity.

Policy reform programs require intensive use of highly skilled professionals. Such programs require technical, economic, social, political, and institutional analysis during planning and implementation if they are to successfully support necessary institutional changes. Consequently, policy-based program assistance may require even more staff time than project assistance.

When planning reform programs in the future A.I.D. must consider the likely impact of the reforms on institutions and individuals and must build into the program design a monitoring and impact assessment system that will help the reformers respond to political-economy issues that arise during program implementation. All of the evaluations found that success was critically dependent on support from key elements in the host country. While the reform measures were of a technical nature (prices, interest rates, subsidies), the results were not merely technical but affected economic and social interests as well. The reforms were designed to change structural relationships, which meant differing impacts on different institutions, individuals, and interest groups. Understanding the political-economy aspect of policy reform is critical to the success of program efforts.

Although longer term benefits may be large, A.I.D. should also consider the costs of adjustment and the transitional pain for those most severely affected by the reforms. Policy reform means economic adjustment and dislocations that generate social and personal costs. Mali was the only one of the six country programs that included specific measures designed to soften the adjustment process. The Mali program included a sizable reduction in civil service staff. A.I.D. helped displaced bureaucrats move to the private sector by funding business training courses, severance payments, and a new enterprise loan fund. Although the social costs of adjustment are important, in most country cases the costs were limited and the benefits large.

A.I.D. must work closely with other donors at all stages of a program. Although donors generally agree on an overall development approach at high-level meetings, problems often arise after individual projects have been approved and during project implementation. At donor consultative group meetings, the donors always speak of their shared approach to development and the need for donor cooperation. In practice, however, donors may have a conflicting approach to development. For example, in Senegal, A.I.D. encouraged tax reforms (lower taxes) to improve economic incentives while the International Monetary Fund (IMF) pushed a program to raise government revenues, which meant higher taxes. Also in Senegal, A.I.D. pushed to remove protection from inefficient industries while the French Government was concerned about Senegal's French-owned businesses. In The Gambia, A.I.D. had an interest rate policy that was very different from that of the IMF and World Bank -- A.I.D. encouraged the cooperative to raise interest rates while the IMF and World Bank did the opposite. Similar problems developed with subsidized project credits provided by the African Development Bank and the International Fund for Agricultural Development.

Data collection and analysis must be included at an early stage in the design of a policy reform program. The evaluations noted the importance of baseline data collection and monitoring. Such programs need an information system to measure progress and impact, and to provide input for the ongoing redesign of the reform effort.

A.I.D. should provide its funds to the public or private sector at the free-market rate, not at the subsidized foreign exchange rate. The Uganda program was the only country program to use a CIP. Although A.I.D. funds were provided at the official exchange rate, the parallel rate was much higher. Importers were eager to receive a CIP allocation, since imports were scarce and importers were receiving cheap foreign exchange. Since A.I.D. is interested in promoting market-based solutions and eliminating subsidies, it should not provide subsidized resources.

One of the surprises of the reform process has been the apparent failure of the reforms to stimulate private investment. Two hypotheses have been offered to explain this failure. One is that private investors have become so accustomed to a rapacious bureaucracy, policy flip-flops, and political instability that they are cynical about apparent reform. Thus, they continue to move their capital abroad or to engage only in short-term, relatively high-return investments. The other hypothesis is that although incentive structures have improved, the failure to develop public infrastructure and to provide adequate public goods has severely restricted profitable private investment opportunities.

If the first hypothesis is correct, there is probably relatively little that foreign assistance can do to restore private investor confidence in the short run. However, if the second hypothesis is correct, there is much that a foreign donor can do. Getting governments out of activities that produce private goods and encouraging them to allocate their resources to the provision of public goods to improve the business climate can also stimulate private investment.

Despite the critical importance of public infrastructure and public goods, the fundamental factor influencing business confidence is a proper policy setting. This fact is the key lesson of the last 15 years. The policy environment must improve if businesses are to have the confidence to invest and to increase their level of activity.

GLOSSARY

A.I.D. Agency for International Development

AEPRP African Economic Policy Reform Program

CFA Central African Franc

GDP gross domestic product

IMF International Monetary Fund

SAL World Bank Structural Adjustment Loan

1. Introduction

The 1980s were the "lost decade" for many African countries. These countries faced a sharply changed economic environment: the favorable price and demand relationships of the 1960s and 1970s had disappeared. Over the years since their independence, most African countries had developed an array of regulations, controls, and subsidies whose inappropriateness was made painfully apparent during the period of economic decline. International donor organizations, as well as the African governments, realized that these policies had to be changed. Moreover, the countries needed to institute a package of incentives to restructure their economies to deal effectively with the new economic environment. In fiscal year (FY) 1985, the Agency for International Development (A.I.D.) introduced a new initiative to support the reform effort -- The African Economic Policy Reform Program (AEPRP).

1.1 The Economic Context for Policy Reform

Policy change can take place at two economic levels: (1) at the broad macroeconomic level (e.g., foreign exchange rate, interest rates, fiscal deficit) or (2) at the sector or subsector level, where specific market reforms are targeted (e.g., agricultural marketing, financial markets, industrial sector, exports). In addition to macroeconomic reforms and market reforms, there are nonmarket reforms, which aim at improving public sector efficiency.

The A.I.D. AEPRPs focused on sectoral reforms that often included important macroeconomic policy conditions (e.g., exchange rate and fiscal policy adjustments). These policy conditions were critical to the success of the A.I.D.-supported sectoral reforms and supportive of the overall stabilization and structural adjustment program of the host country (usually supported by World Bank and International Monetary Fund [IMF] programs). Although the A.I.D. programs supported general macroeconomic adjustment, they clearly focused on sectoral reforms.

In each country A.I.D. identified one or two sectors or subsectors plagued by serious problems that were adversely affecting economic growth. The problems were almost always traced to excessive and inappropriate government controls and restrictions (e.g., price and investment controls, credit allocations, inappropriate taxes and tariffs, or an inefficient government corporation that had a monopoly). From A.I.D.'s perspective the solution generally seemed simple -- the government needed to remove its controls and let private producers use free markets to allocate resources efficiently. However, the host government often had a different view of the problem and its solution.

Government officials in many developing countries typically did not fully share A.I.D.'s view on the value of a private sector operating through free markets. They were concerned about market imperfections, monopolies, and an exploitative private sector. They feared that without direction and controls, the poor would suffer; there would be capital flight, and the nation would not prosper. Over the years, as problems developed, the answer was often to apply even more controls. Government officials also typically had vested political and economic interests, making them reluctant to open the economy to competition.

Given the severe economic problems, many developing country officials were convinced of the need for change. More difficult was the job of convincing them to focus on market-based reforms. The reforms promised substantial long-run benefits but potentially at an initial economic and political cost. In order to encourage host governments to implement policy reforms that posed a degree of risk, A.I.D. typically provided financial resources to help ease the reform transition and technical assistance and training to assist the governments with the technical requirements of implementing the reforms.

1.2 The Reforms

The A.I.D.-supported reform programs cover a broad range of sectors and subsectors. While the areas of reform are not directly comparable between countries, they all involve change in key economic policies, and in key economic sectors that are critical to economic growth. (Box 1 provides a listing of the reforms and the countries where they were implemented.) The reform objectives are listed below. (The actual results are discussed in Section 2:)

> In Cameroon and Malawi the reforms were designed to liberalize the fertilizer market. In Cameroon this meant the establishment of a private, competitive fertilizer market with a

phase-down of government subsidies and government controls. In Malawi the program was designed to reduce the fertilizer subsidy and reduce foreign exchange costs by importing less fertilizer but fertilizer with proportionately more nutrients and less filler, thereby boosting crop production at lower transport costs.

In Mali the reforms were designed to move the Government away from its centralized, statist economic approach to a less regulated economy with an improved private sector climate and improved public sector efficiency.

In Senegal the reforms were designed to increase the competitiveness of the private industrial sector and improve the efficiency and equity of the tax system.

The Gambia program was designed to encourage greater private sector involvement in agriculture marketing and investment while sharply reducing government regulation of agricultural and financial markets.

In Uganda reforms focused on the foreign exchange system and were designed to encourage private sector nontraditional exports.

Box 1. Policy Problems Addressed in the Six Programs

Policy Problem	Mali	Gambia	Cameroon	Malawi	Senegal	Uganda
Price and Market Controls	X	X	X			X
Subsidies and Projected Markets			X	X	X	
Import and Export Controls	X				X	X
Incomplete Reform of Linked Markets	X	X	X		X	
Weak Tax Administration	X				X	
Inadequate Policy Reform Capacity	X	X	X	X	X	X

2. The Policy Reform Programs

2.1 Mali

2.1.1 The Economic Problems

The private sector in Mali was choking under excessive government regulation and control while an inefficient public sector failed to deliver public services effectively.

In Mali the Government's influence was pervasive, extending throughout the economy to include banking, crop marketing, industry, foreign trade, and local commerce. Largely because of the fact that the Government provided jobs to all college graduates, the civil service was bloated to the point of inefficiency. The civil service wage bill, subsidy payments, and debt service consumed a large and growing portion of the Government's budget. A dwindling share of the budget went to purchase the supplies necessary to run the Government and to provide basic services to the people.

By the early 1980s, as a result of a State-led development strategy and an extensive system of controls and regulations, the economy faced serious difficulties; the budget deficit amounted to one-third of revenues, losses incurred by public enterprises amounted to 20 percent of sales, and the balance of payments gap was large and unsustainable. Mali needed to shift from a centralized economy, dominated by the Government, to a less regulated economy with increased private sector opportunities. From 1982 to 1988 the Government of Mali implemented a series of economic and financial adjustment programs supported by the IMF, World Bank, and A.I.D.

2.1.2 A.I.D. Policy Reform Objectives

The A.I.D. reforms focused on the twin problems of a public sector that had difficulty delivering goods and services and a private sector that was hamstrung by excessive government controls and regulations. The solutions to the problems were twofold:

> Improve Malian Government efficiency by freeing up resources for supplies and equipment. This task was to be achieved by (1) improving tax administration, which would increase revenues, and (2) slowing the growth of the civil service by curtailing new hiring and encouraging early retirements.
>
> Enhance the climate for private sector activity through a revised commercial code, lower tax rates, an easing of price controls, and liberalization of import and export requirements.

2.1.3 The A.I.D.-Supported Policy Reforms

Public Sector Restructuring

Improved tax administration. A government will always be short of revenue if there is large-scale tax evasion, fraud, and inefficiency in tax collection. The A.I.D.-supported reforms sought to improve tax collections by gradually automating income-tax returns; by strengthening tax investigation and cross-checking; and by expanding the Customs Department's computer system.

The reforms appear to have had a limited, though positive, impact on tax collections. Overall tax revenues were down in 1987 and 1988 due in part to tax rate cuts designed to stimulate the private sector and the depressed state of the economy. However, in some areas where tax rates had not been cut, collections were up because of the improved performance of the tax collectors. General income tax collections and domestic sales taxes were up 30 percent and 17 percent respectively between 1985 and 1988. The evaluation also found that improved customs assessments and automation had bolstered customs revenues. An additional factor was the demonstration effect of legal proceedings against delinquent tax payers.

The delivery of public sector services. To improve public sector efficiency, policy reforms required the Government to shift funding from personnel to materials, supplies, and equipment to provide government employees with the materials they needed to perform their jobs effectively.

The evaluation measured policy reform success in terms of the ratio of material expenses to personnel expenses. The ratio changed for the better as the wage bill was kept under control and the amount of money spent on supplies increased sharply.

It would be fine to claim a successful reform and stop at that point in the analysis. However, the evaluation team closely examined the increase in material expenditures and found that 77 percent of the increase went to the Ministries of Defense and Foreign Affairs and the Presidency. Except for education, which received 19 percent of the increase, the economic and social sectors (e.g., agriculture, natural resources, health, commerce, and finance) did poorly. Thus, although the impact of budget restructuring increased government expenditures on materials, the increase was not necessarily in the developmental areas that A.I.D. preferred.

Voluntary early departure (VED) program. The VED Program is a bridge between the public sector restructuring and private sector promotion sides of the policy reform program. To reduce the bloated civil service wage bill, government employees were offered an early retirement option with a large severance payment. The early retirees were then given technical support and financing to help them become established in the private sector.

More civil servants took early retirement than expected. The budgetary savings from the first year were slightly over 1 percent of the Government's wage bill. While relatively few participants used the A.I.D.-funded feasibility studies or loan funds, the majority used their severance payments to establish their own businesses.

The VED Program was successful to a point. The number of participants exceeded the target by a good margin, and the budget savings were real. However, a far more effective means of controlling personnel costs proved to be the cap on the number of new entrants into the civil service, which allowed jobs to disappear through normal attrition.

More than half of the VED participants were teachers; it may therefore have been a mistake to let them retire. Given the poor state of the education system in Mali and the low literacy rate, future development may suffer. Another problem was the total inexperience of some departees to properly invest or conserve their funds. They may become part of the problem instead of part of the solution.

In summary, the changes in public sector efficiency were marginal at best with the real challenge outside of the A.I.D. program. The Government still needs to take a fresh look at budget priorities and budget planning in order to improve Mali's economic development prospects.

An Improved Private Sector Climate

The private sector reform program achieved the objective of improving the private sector climate -- which is extremely impressive given the unfavorable economic climate of a stagnant economy.

Price controls. Previously, all prices were controlled. As the reform program moved forward, more and more prices were freed from controls, and by the time of the evaluation, only 10 essential products were subject to price controls.

Based on an A.I.D.-funded survey of some 100 business concerns, the price decontrol program appears to have had considerable positive impact. Consumers and businesses have benefited from decontrol, because prices have tended to decline across the board, suggesting enhanced economic efficiency. The drop in prices was a surprise since many government officials had expected prices to increase once controls were lifted. The evaluation found that business had previously built in higher profit margins to pay the fines and bribes required under the old price control system. With the elimination of harassment and the uncertainty and cost of fines, businesses could now operate profitably at lower mark-ups. The main losers were the "economic police," who had enforced price controls or accepted bribes to look the other way and were now out of a job.

Tax reform. As part of the reform program the Government cut corporate income taxes, payroll taxes, and the business turnover (sales) tax. The tariff schedule was cleaned-up to eliminate negative protection for a number of industries that imported raw materials and semifinished goods. Based on evidence from an A.I.D. survey of formal sector firms, the tax reform package has had modest, though positive, economic benefits. Although the individual tax cuts were relatively minor, in their entirety they provided incentives for firms to increase output, investment, and employment.

The benefits of the tax reforms were offset largely by another government tax increase: the annual business license tax, which was increased substantially. In addition, import valuations and other tax interpretations were adjusted upward. These increases demonstrate a problem with policy reforms. While the reformers concentrated on eliminating one set of disincentives, new ones were created. In this case, reforms designed to provide new private business incentives also meant a loss in government revenue. Rather than lose revenue, the Government reversed its policy of cutting business taxes.

The lesson in this case is clear: Unless all elements of the government understand and support the reform process, potential counter-pressures will negate the reform effort.

The commercial code. The Mali Government enacted a new, comprehensive commercial code that simplified the rules, facilitated business registration, and replaced a number of cumbersome procedures. The commercial reforms were designed to lower the cost of doing business, increase tax revenues, increase access to formal sector credit, and encourage firms to increase output and employment. A measure of the reforms' success was the 370-percent increase in business registrations recorded between 1986 and 1988 and another 20 percent increase in 1989, a significant improvement given the economic decline of the period. The A.I.D. survey of businesses found that informal sector firms, and even some formal sector firms, were registering as a way to avoid legal disputes and to avoid arbitrary tax assessments. Although the survey identified a number of benefits, it found the overall impact of the reforms on the business environment to be marginal. The absence of an effective commercial court system, the failure to enforce laws, and a meddlesome government bureaucracy limited the benefits of commercial reforms.

Import and export controls. In 1988, the Government discontinued import quotas on 10 essential products and provided automatic import licenses for some 40 percent of imports. In 1989, the remaining import quotas were abolished and import and export licensing was replaced by a simplified registration system. Because these liberalized trade procedures were implemented only recently, their specific impact cannot yet be accurately assessed. Nonetheless, it is probable that their impact will be modest. Importing still remains cumbersome, and the Government has added new antifraud measures designed to eliminate underinvoicing, which adds delays and paperwork to the importing process.

2.1.4 Factors Influencing the Performance of Policy Reforms

Time horizon. The economic reforms took place in one of the world's poorest countries at a time of slow economic growth. Reform and change are difficult in a country that lacks resources and has poorly developed markets and institutions. A.I.D. therefore must continue the policy dialogue to build confidence and to help the Government stay on the reform track. Nothing comes quickly in a difficult economic environment such as Mali's, where reforms take many years to fully implement. A.I.D. needs a longer time horizon than the 5 years planned for this program.

Targeting. The program's notion that the reforms would produce greater public sector efficiency suggested stronger linkages between the Government and the private sector than existed. In addition, improvement in the public sector's delivery of services are hard to measure because benefits are diffused throughout the economy and are hard to quantify. To achieve more visible results, the evaluation suggested targeting reforms to a specific sector such as education. A.I.D.-targeted assistance, therefore, should be focused on areas of the economy with the greatest economic returns.

Program management. The design and implementation of the reforms (e.g., price decontrol, reduced taxes, an improved commercial code, trade liberalization, and public sector restructuring) required high levels of technical skills. Policy reform proved to be staff intensive for both A.I.D. and the Government of Mali -- and more staff-intensive than project assistance.

Monitoring and evaluation. The design of the program was relatively straightforward but implementation and in particular monitoring were a great challenge, given the widespread data problems. A.I.D. funded three special studies to collect information on program impact but much still needs to be learned. A monitoring and evaluation effort is important if A.I.D. and the Mali Government are to understand the impacts of reforms and how to redesign and improve reform efforts.

Softening the pain of adjustment. A.I.D. and the Government decided that one group should not bear the brunt of the adjustment costs. Consequently, A.I.D. provided training, severance payments, and a loan fund for civil servants who were displaced when the Government was downsized. This approach humanized and softened the adjustment process.

Longer term development. To reduce the government deficit, the civil service staff was cut. Although this action clearly generated immediate budget savings, it may have created an even greater long-run loss because many of the retirees were teachers. Fewer teachers reduce the Government's ability to increase Mali's school enrollment and literacy rates. Based on this experience targeting staff reductions to nonpriority sectors may be preferable to indiscriminate reduction of civil service staff.

2.2 The Gambia

2.2.1 The Economic Problems

There was a need to encourage and expand the role of the private sector while discouraging the Government from overregulating and controlling the economy.

The Gambian economy began unravelling in the mid-1970s, and by 1985 conditions had reached crisis proportions. Between 1976 and 1985, per capita income, adjusted for inflation, fell by one-fourth. The economic problems were due to two factors:

The first problem was a decline in world prices for groundnuts (The Gambia's major export) and an increase in the price of oil and other imports. By 1982-1983, Gambia's terms of trade index had fallen to one-third the level of 1976-1977. Trade deficits were substantial after 1979, and foreign borrowings steadily increased. The second problem was poor management of the public sector. Ever-growing public expenditures and public employment generated a large and chronic fiscal deficit. An inefficient public sector and a repressed private sector were dragging the economy downward.

By 1985 urban consumers were unable to find enough rice and other basic foods on the local market. Fuel, medicine, and other essential imports were not available at any price. Business confidence was shattered, private investment dropped to nearly zero, external public debt was twice the level of gross domestic product (GDP), and The Gambia was $75 million in arrears to the IMF and other international creditors: The economy was grinding to a halt. To remedy the situation donors provided support as the Government launched an overall economic recovery program. A.I.D. supported the portion of the reforms covering financial and agricultural markets.

2.2.2 A.I.D. Policy Reform Objectives

The A.I.D.-supported reforms were designed to create, at the sectoral level, a policy and institutional environment that would encourage and promote greater access to markets for private entrepreneurs.

The economic problems centered on two Government-supported institutions, the Gambian Cooperative Union and the parastatal Gambian Commercial and Development Bank. Both institutions used their position to provide subsidies and to control markets. The Bank directed credit to special borrowers at subsidized interest rates, and the Cooperative controlled the distribution and prices of agricultural inputs, outputs, and exports. Private entrepreneurs took a very limited market role, which was understandable because the Cooperative and the Bank had set uneconomical prices and controlled markets inefficiently.

2.2.3 The A.I.D.-Supported Policy Reforms

The A.I.D.-supported policy reforms were designed to reduce the role of government parastatals, to end the flow of subsidized credit to the parastatals, and to end the repression and control of financial markets. A.I.D. believed that the establishment of appropriate interest rates and the elimination of preferential credit allocations would allow The Gambian economy to experience more savings, more efficient investment allocations, and an end to capital flight. Moreover, the elimination of preferential buying allowances and the end of favorable interest rates and subsidies for the Cooperative would encourage fair and equitable competition between the public and private sectors involved in groundnut marketing.

Financial Market Reforms

A.I.D. conditionality put an end to preferential credit allocations, and all borrowings from official sources were to be at market-determined interest rates.

The dramatic rise in interest rates resulted in a significant increase in savings. Between September 1987 and June 1989, demand, time, and savings deposits increased by 40 percent. Loans grew less rapidly, due in part to credit ceilings imposed by the IMF. Commercial bank loans to the private sector rose by 15 percent, and agricultural marketing loans moved erratically, perhaps signaling some uncertainty and lack of business confidence. Private sector investments in agricultural input and output marketing appear not to have increased.

In the past the Gambia Commercial and Development Bank often financed unprofitable investments of government parastatals and the Gambia Cooperative Union. As a result the Bank has essentially been bankrupt for years. As part of the reform program the Government took two measures to improve the Bank's financial position: (1) It accepted responsibility for a portion of the Bank's bad loans to the Cooperative Union, and (2) it demanded the overhaul of the Bank's management. The prospects are encouraging, but because the two measures have just recently been implemented, it is too soon to assess their impact.

Agricultural Marketing Reforms

A.I.D. conditionality required the parastatal Gambia Produce Marketing Board to pay the same prices to all licensed traders (both public and private) who sold groundnuts to the

Board. This measure ended the higher buyer's allowances that had been paid by the Board to the Gambia Cooperative Union. The reform was designed to improve the efficiency and to reduce the costs of the groundnut buying business by encouraging competition between the Cooperative and private traders.

Even with equalized allowances between private and government traders, the private traders were reluctant to enter the groundnut buying market. One reason was the linkage of agricultural markets. The Cooperative continued to hold a de facto monopoly in fertilizer distribution. Many farmers, unwilling to jeopardize their access to fertilizer, continued to sell most of their groundnut crop to the Gambia Cooperative Union. They felt that if they did not sell their crop to the Cooperative, the Cooperative would not sell them fertilizer.

Another problem was the artificially low groundnut buying allowances. While the Cooperative simply went further into debt and failed to repay its bank loans, the few private traders who tested the market were badly squeezed. In addition the Cooperative had access to low-cost financing and equipment provided by foreign aid donors (see Section 2.2.4). Thus, equalization of allowances had virtually no immediate impact on groundnut marketing.

There are, however, some encouraging signs. In 1988-1989 the amount of groundnuts handled by the Gambia Cooperative Union fell to the lowest level in years. Although official data do not provide a clear answer, much of the crop appears to have been sold (some smuggled) by private traders to Senegal, because the Senegalese price for groundnut was higher. This suggests that when a profit is to be made, the private sector can organize the finances and transportation required to move the crop.

2.2.4 Factors Influencing the Performance of Policy Reforms

Donor coordination. Policy reform coordination among donors, especially among A.I.D., the World Bank, and the IMF at the macroeconomic level, was outstanding during the design of the reforms. The problems developed during the implementation phase as each donor went its own way. The World Bank, International Fund for Agricultural Development, and the African Development Bank each developed and implemented separate projects that provided subsidized agricultural credit. And subsidization went counter to A.I.D. efforts to eliminate cheap credit. Moreover, donors provided grant equipment and materials to the Cooperative, which gave it an unfair advantage over its competitors in the private sector. Although procedures for donor coordination worked well for macroeconomic planning, they did not work as well for project implementation.

Technical assistance. Policy reform is a process that requires constant monitoring and adjustment as the effects of each new policy emerge. Many governments lack the necessary technical skills needed to study and suggest policy adjustments during the reform process. A.I.D. originally planned to provide a complementary technical assistance grant of $850,000 to help the Government develop policy options in term lending and agricultural credit and development lending, and to help monitor policy reform performance. Due to contract delays, the technical assistance was never provided. Under another A.I.D. project some technical assistance was provided to the Ministry of Finance and Trade, which helped in part to fill some of the gap. A.I.D.'s failure to provide the originally planned technical assistance made it more difficult to work out the technical details of implementing the policy reforms.

Institutional development. A change in policies or prices does not necessarily translate into the desired impact if institutions are not ready to support the process of change. A policy can be decreed -- with the stroke of a pen, but an institution must implement it. The institutional inertia of the Gambia Commercial and Development Bank and the efforts of the Gambia Cooperative Union to continue to play by the old rules limited the impact of the policy reforms. Because of institutional rigidities, policy pronouncements were not enough to change the structure and functions of institutions or to influence the behavior of individuals in those institutions. Institutional change is usually difficult and requires a concerted political will, much time, and substantial amounts of technical assistance.

Linked markets. In The Gambia, an important reason for high domestic interest rates is the close link between domestic and international financial markets. High domestic interest rates stimulate capital inflows and inhibit capital flight. The domestic financial market cannot operate independently from the international financial markets.

Fertilizer and groundnuts are another set of interrelated markets. One reason the Gambia Cooperative Union is able to retain its market share of the groundnut marketing business is because the agricultural output and input markets are closely linked. Farmers are inhibited from dealing with private traders (rivals to the Cooperative) out of fear that the Cooperative (given its virtual monopoly power) will deny them access to fertilizer. Project designers must extend their analysis to cover a broad range of economic issues and must be especially sensitive to the problems posed by linked markets.

Staff requirements. Nonproject assistance, such as policy reform programs, are often viewed as a way to avoid the large staff requirements of project assistance. In fact, policy reform programs require high levels of technical and managerial expertise for analyzing and developing the reform programs and for handling the institutional and operational problems of implementing the reforms. Policy reform is labor-intensive for both donors and the host government.

Policy changes and the investment climate. The A.I.D.-supported reforms liberalized the financial and agricultural markets, but private investment was slow to take advantage of the new opportunities. Given an uncertain political and economic environment, investors were reluctant to make fixed investments. They put most of their money into short-term investments, inventories, and some real estate. It takes time for investors to trust a government that has long been hostile to their role in the economy. The overall investment climate is often more important than changes in interest rates or policy announcements.

Time frame. It can take 5 to 10 years for policy reforms to produce major changes in agricultural and capital markets, institutions, and the business climate, but the reforms in The Gambia have been in place for only a short time. The 3 years covered by the A.I.D.-supported reform program are not sufficient to allow impacts to fully emerge.

2.3 Cameroon

2.3.1 The Economic Problems

The agricultural sector in Cameroon was suffering because needed inputs and services were available only from inefficient and high-cost parastatals.

Cameroon's period of rapid economic growth came to a sudden halt in 1985-1986 as world prices for the country's major exports -- oil, cocoa, coffee, and cotton -- dropped by more than 40 percent in 2 years. A major problem was the coffee sector, where a large number of high-cost coffee farmers were unable to produce coffee at a competitive price for an international market experiencing slow growth and low prices. By 1986/1987, gross domestic product (GDP) had dropped to 75 percent of its 1984/1985 level. The national budget, already strained by losses incurred by more than 150 public enterprises, increased its deficit from 3.3 percent of GDP in 1984/1985 to 11.8 percent in 1986/1987. An important part of the problem was the large subsidy payments the Government made to money-losing government parastatals. These parastatals not only represented a major drain on the budget but also encouraged economic waste and inefficiencies. As part of a multidonor effort, A.I.D. supported reforms in the agricultural sector, targeting the parastatal that distributed subsidized fertilizer.

2.3.2 A.I.D. Policy Reform Objectives

The A.I.D.-supported policy reforms in Cameroon were designed to provide fertilizer to farmers on a timely basis, at low cost, and with minimum cost to the Government.

Fertilizer imports and distribution had previously been handled by the Government and government-run parastatals. The A.I.D.-supported reforms ended the Government's complete control of fertilizer by establishing a private market for the import, distribution, and financing of fertilizer. The program objective was to end the public fertilizer monopoly and to establish a competitive, sustainable, and subsidy-free fertilizer market.

Economic liberalization required the dismantling of the public monopoly and its supporting institutional arrangements. The change required an end to public fertilizer procurement, complete privatization of the import and distribution of fertilizer, and the gradual elimination of fertilizer subsidies.

Privatization involved more than just ending the public monopoly. To make privatization succeed financial incentives were needed to attract and sustain private sector participation; the private sector needed access to working capital credit; and the sector's entrepreneurial capacity had to be developed and promoted. The reforms were designed to serve these needs.

2.3.3 The A.I.D.-Supported Policy Reforms

The reforms were phased in sequentially, with a new incentive system and new institutional arrangements to replace the public monopoly. However, putting in place a quasi-market system proved to be complicated and management-intensive for both the Government and the USAID Mission.

On the public sector side, an interministerial group, the Technical Supervisory Committee (TSC), helped oversee and manage the transition. Contractual arrangements were negotiated and signed among the TSC, a fiduciary bank, the commercial banks, importers, and distributors. A differential pricing system, subsidies, and credit funds were used to help ease the transition to a free market. Between October 1988 and February 1989, 63,000 tons of fertilizer were imported by three firms (which were awarded contracts from among 10-12 firms that bid) and distributed by four cooperative unions. In the next season, four private traders and five cooperatives distributed the fertilizer within the country.

Reduced Fertilizer Subsidy. The government steadily reduced the subsidy, lowering it from 66 percent in 1987 (before the reforms) to 43 percent in 1988 and 35 percent in 1989. The budgetary savings from the reduced subsidy between 1988 and 1989 were $13.9 million.

The Government's budget savings were only part of the story. The evaluation found that under the old subsidy system collusion and kickbacks among some government officials, importers, and cooperatives added to the distribution costs. The inflated distribution costs quickly disappeared when private sector competition was introduced. The efficiency gains in distributing fertilizer reduced not only average delivered costs but also the potential negative impact of the lower subsidy on farmers. The remaining subsidy was passed from the importers through the distributors to farmers by competitive forces at all levels in the marketplace. In the second year, 1989, when the subsidy rate was decreased 20 percent, prices to farmers increased by only 4.2 percent. Thus farmers clearly benefited even though the subsidy was being cut.

The evaluation found some difficulties during the start-up of the program when fertilizer did not reach all farmers in time for application. The delay was due to the fact that the Government and the USAID Mission were working on rules, procedures, and relationships among participants, as well as on overcoming a certain degree of Government bureaucratic resistance to the program.

Except for the initial delay, the overall impact of liberalization was highly beneficial and positive. Although the reforms initiated a major change in the fertilizer distribution system, disruptions were minimal: The system continued to distribute roughly the same amount of fertilizer as in the prereform period; corruption decreased as the Government's fertilizer monopoly ended; significant budgetary savings accrued to the Government; and farmers were shielded from undue price increases by efficiency gains made in the import and distribution system.

Linked Markets. Coffee farmers need agricultural inputs, such as fertilizer, to grow crops and a market where they can sell their output. Prior to the reforms both inputs and outputs were handled by government parastatals. After the reforms, coffee farmers purchased their inputs from the private sector but still could only sell their product to the parastatal National Produce Marketing Board. The Government was often late in paying for coffee and did not have the money to fully pay for the crops harvested in 1988 and 1989. Consequently, farmers were reluctant to produce coffee. Although they continued to purchase fertilizer, they used it on crops other than coffee. Since coffee is a major foreign exchange earner, the shift away from coffee production may reduce foreign exchange earnings and add to an already difficult balance of payments situation. Thus, when markets are linked, as in this case, reforms in only one market may be undercut if the other market remains unchanged. In Cameroon, the benefits of the reforms on the input side were undercut by the unreformed output side. The solution may be privatization of the coffee market.

Managed Free Markets. Rather than end the Government's fertilizer monopoly and go straight to a free market, the USAID Mission established a system that included subsidies, special access to credit, and a carefully managed movement toward free markets. Although the plan was to relax the controls and subsidies over several years, the market remains quasi-free.

The evaluation questioned the assumption that free markets cannot develop without outside intervention and direction. In particular, the evaluation questioned the USAID Mission's intensive involvement as rulemaker and watchman. It pointed to the danger of a permanent quasi-market forming as everyone comes to depend on the subsidies provided by the new system. Moreover, those in the system might have advantages that would prevent others from entering the market: the participants would already know the framework, the market rules, and the people involved. The evaluation argued that the reforms would have a better chance of being sustainable if A.I.D. and the Government would withdraw from the market and let it move quickly to a true free market. The role of arbitrator or market administrator is not appropriate for a government or A.I.D. Free markets rather than government bureaucrats should allocate resources.

2.3.4 Factors Influencing the Performance of Policy Reforms

Commitment to reduce the budget deficit. The Cameroon Government realized that it faced a growing and unsustainable budget deficit. It therefore was committed to reforms that would reduce the budget burden of the fertilizer subsidy. Government support made it possible to introduce strong reforms to sharply cut back the fertilizer subsidy.

An overvalued foreign exchange rate. Cameroon is part of the Central African Franc (CFA) zone in which the CFA has a guaranteed, fixed exchange rate with the French franc. The CFA is considered by many in the market to be overvalued. An overvalued currency slows investment of off-shore funds, makes imports relatively cheap, and discourages exports. The reforms were designed to increase exports, but the overvalued CFA (an external factor outside the control of reformers) discouraged coffee exports.

Rural purchasing power. The Cameroon banking system is carrying about $1 billion of nonperforming loans on its books, which, in turn, freeze assets and deposits. After a string of budget deficits, the Government and government parastatals are short of operating capital and the Government does not have the money to pay farmers for the coffee crops harvested in the 1988 and 1989 seasons. The economy needs more liquidity but, as a member of the CFA zone, Cameroon cannot print money to increase the money supply. Reforms are threatened when farmers lack cash to buy fertilizer, are reluctant to grow cash crops (such as coffee), and do not receive payment for their output. Fiscal and monetary problems harmed the A.I.D.-supported reforms.

Linked markets. The reforms concentrated on the input side, fertilizer, but did not deal with the output side, the sale of agricultural products such as coffee. Fertilizer was privatized, with distribution partially decontrolled and subsidies partially removed. However, farmers still had to sell their output to a government marketing board that did not offer a good price and often did not pay the farmer for the coffee it purchased. Reforms in one market can be undercut if a closely linked market remains unchanged.

A monitoring and evaluation system. The manager of a policy reform program needs to know the impact of reforms. A monitoring and evaluation system should be in place at the start of a policy reform program to generate such data. Baseline data can then be used to measure and analyze the impact of policy changes.

The pace of reform and A.I.D.'s role. The USAID Mission did not press for full and immediate privatization; instead it pursued a quasi-market approach that slowly phased in the reforms. The evaluation team and the Mission had a significant disagreement about the time needed to establish the conditions for a competitive free market structure. The Mission believed that it needed to help the Government and the private sector to slowly move to a new system. As a result, it assumed the role of arbitrator in organizing the new fertilizer market. In contrast, the evaluation team believed moving quickly to a freely competitive marketplace would have made more sense. The evaluation team further believed that A.I.D. should not have assumed the role of market administrator or encouraged the Government to continue subsidies and controls. A.I.D. should allow free markets to move quickly to the point at which they can allocate resources, rather than delaying the process and, in the interim, having A.I.D. and host government bureaucrats make market decisions.

2.4 Malawi

2.4.1 The Economic Problems

Malawi had to reduce its balance of payments deficit and to trim the Government's budget deficit. Improvements in the agricultural sector were central to any reform effort.

Of Malawi's arable land, 12 percent is "estate land", which produces cash crops, mainly for export, for example, tobacco, tea, and to a lesser extent sugar and coffee. The rest of the land is farmed by smallholders who mainly grow food crops. The Government historically had a pro-estate bias, with laws and policies designed to encourage the production of tobacco and tea on estates, which effectively discouraged increased production on smallholder farms. In addition, price controls, subsidies, and inefficient public enterprises were discouraging efficient resource allocations and depressing economic growth. Starting in 1980, the Government began a series of economic reforms.

By 1985 a number of reforms had been launched but problems remained: Government borrowing was up and appeared likely to rise further if budget deficits were not reduced. In 5 years, the money stock had doubled; the general price level had risen by 70 percent; and the rate of inflation appeared likely to increase if Government deficits were not reduced.

Malawi needed economic policies that were neutral, rather than favoring the estate sector. Smallholders needed prices that were determined by free market demand and supply forces for their farm inputs and outputs. Such reforms would help increase agriculture production, reduce the balance of payments deficit, and lower the Government's budget deficit.

2.4.2 A.I.D. Policy Reform Objectives

In 1985 the Government of Malawi entered into a World Bank Structural Adjustment Loan (SAL). A.I.D. piggy backed onto the SAL with an economic policy reform program that focused on fertilizer reforms. The evaluation team identified two A.I.D. policy reform objectives: (1) to cut the fertilizer subsidy in order to reduce government budget outlays and to make prices a more efficient guide to farmers' decisions and (2) to substitute fertilizer richer in nutrients (high analysis fertilizer) for the less concentrated (low analysis) fertilizer. These steps would reduce transport costs and save foreign exchange. Also, the elimination of the subsidy would encourage smallholder farm families to diversify their crops and use resources more efficiently.

2.4.3 The A.I.D.-Supported Policy Reforms

A.I.D. focused narrowly on fertilizer reforms because the Government appeared willing to implement reforms that would generate substantial benefits in a short time frame. The problems of "estate bias", inefficient parastatals, and other policy constraints were left to the World Bank.

The A.I.D. reform package was a simple, straightforward two-pronged approach, with each part of the reform package supporting the other. The first part set a timetable for a phased reduction in the fertilizer subsidy. The second part required a change from low-analysis fertilizer to high-analysis fertilizer in order to reduce the cost of imported fertilizer and to save foreign exchange.

A reduced fertilizer subsidy. In the 2 years before the reforms (1983-1985) the fertilizer subsidy rate was 29 percent and 25 percent respectively. During the 2 years the reforms were in force (1985-1987), the subsidy rate fell to 21 percent and then to 18 percent, heading downward to the subsidy target of 12 percent for 1987-1988. So far so good -- the subsidy rate was heading downward at a rapid pace.

In 1987, however, a major transportation problem developed. Imported fertilizer could not be shipped through Mozambique and instead had to be shipped over the more expensive South African route, so transport costs increased. The

Government provided a subsidy to cover the increased transport costs, which went counter to the reform objectives. With the subsidy back to 24 percent, rather than the targeted 12 percent, A.I.D. suspended disbursements of its policy reform assistance.

Even though the reforms ended early, the lower fertilizer subsidy cost brought the Government a budgetary savings of $1.8 million for the 1985-1988 period. While any budgetary savings are important, in this case the savings were neither large nor sustained.

The introduction of high-analysis fertilizer. A bag of fertilizer contains nutrients plants need, for example, nitrogen, phosphate, and potash, but the bag also contains inert materials or fillers that are of no agricultural value. Low-analysis fertilizer often has only 25-40 percent nutrients, whereas high-analysis fertilizer may have 50-70 percent nutrients. Thus, it may take twice as much of the less concentrated fertilizer to cover a crop area, which means twice as much fertilizer would have to be imported. Technically, it makes little difference to the health of the plant which type of fertilizer is used, but for the Government the financial differences can be significant. Since Malawi imports fertilizer from abroad and much of the fertilizer is shipped long distances, transport costs are substantial. A switch to high-analysis fertilizer could therefore produce substantial foreign exchange savings.

A.I.D. negotiators overcame Malawian resistance to the substitution and convinced the Government to switch from low to high-analysis fertilizer. A.I.D. negotiated at the technical level with agriculturalists and with policymakers at the higher levels of Government. From 1985 to 1990 fertilizer nutrient sales went up 100 percent, but the tonnage increased by only 55 percent. The shift produced substantial savings ($18 million) in transport and fertilizer costs. In future years the savings will continue to grow as the more concentrated fertilizer is substituted for the low-analysis fertilizer and total fertilizer use rises. The savings from the substitution more than matched the fertilizer subsidy costs and the cost to the smallholder from the subsidy reduction. This part of the reform therefore was clearly successful.

2.4.4 Factors Influencing the Performance of Policy Reforms

Factors outside the control of the reformers affect success. An objective of the A.I.D.-sponsored reform program was to provide economic incentives for smallholders to diversify their crops away from maize to higher value crops, such as groundnuts and tobacco. The reduction in the fertilizer subsidy was expected to encourage that shift. However, the shifts in cropping patterns since 1985 have been the reverse of those objectives. The fertilizer subsidy played a relatively small part in farmers' cropping decisions. The relative profitability of crops depends on parastatal procurement prices and other factors -- not just on fertilizer costs or subsidy levels.

Complementary technical assistance and training. A.I.D. provided $1.9 million of technical assistance and training to support the reform program. An A.I.D.-funded study helped encourage the Government to increase fertilizer and maize prices. Another study helped the Government divest and restructure nonmarketing functions from the agricultural parastatal. A.I.D. also encouraged the switch to high-analysis fertilizer. Technical assistance can provide important support to policy reforms.

The larger policy environment. During the 10 years of structural reform, Malawi's policies have continued to favor estate agriculture and to depress returns to smallholders. Estates grow tobacco but smallholders are prevented from growing tobacco. In addition, the estates sell their cash crops at export parity whereas the parastatal sets low prices for smallholder crops. Although the A.I.D.-supported reforms were successful, the overall policy environment was less than satisfactory. A partial reform of some policies may not do enough to solve basic structural problems.

Staff Time. The policy-based assistance in Malawi required substantial specialized A.I.D. staff time to monitor and implement the reforms. Conventional wisdom in the Agency viewed nonproject assistance as less staff intensive than project assistance. The evaluation found the opposite to be the case.

2.5 Senegal

2.5.1 The Economic Problems

An overly protected industrial sector was becoming more and more inefficient. Government tax, tariff, and investment policies only made the situation worse.

By the mid-1980s, Senegal was experiencing major economic difficulties -- difficulties that were especially evident in the industrial sector. Because of years of heavy tariff protection and fiscal policies that reduced domestic purchasing power (by heavily taxing the agricultural sector and consumers alike), the industrial sector had become stagnant. Government revenues were declining and the economic costs of industrial protection had become unsustainable. As part of a multidonor structural adjustment program led by the World Bank, the A.I.D. program supported industrial policy reforms over a 3-year period, from 1986 to 1988.

2.5.2 A.I.D. Policy Reform Objectives

The A.I.D.-supported reforms were designed to increase the competitiveness of the private industrial sector and to improve the efficiency and equity of the tax system. The reforms focused on investment incentives, tax and tariff rates, and tax administration.

The solutions to the problems included efforts to broaden the tax base and improve the equity of the tax system, stem the decline in tax receipts relative to increases in GDP, remove disincentives to savings and productive investments, reduce industrial protection constraining imports, reduce government interventions in the economy, increase incentives for productive investment, and improve competitiveness in the industrial sector.

2.5.3 The A.I.D.-Supported Policy Reforms

The reforms included measures to substantially reduce quantitative import restrictions, to liberalize access to imports, to implement a new commercial investment code, to reduce industrial protection, to revise the tax system, to simplify and improve tax administration, to widen the tax base, to reduce tax evasion, and to introduce an urban real estate tax. A.I.D. technical assistance helped the Government revise its tax code and evaluate the impact of the tariff reforms.

Customs reform. The Government of Senegal adopted a new customs code and substantially reduced quantitative restrictions on imports, allowing commercial and industrial firms broad import authority. The removal of import quotas, the elimination of import bans, and the liberalization of conditions required to obtain an import license encouraged many new firms to import goods. Customs rates were substantially reduced as well: import duties decreased by 11 percent for imports competing with domestically produced consumer goods, by more than 30 percent for imports not directly competing with domestic production, and by 12 percent for semifinished products.

Between 1987 and 1989 imports increased modestly, imports of industrial inputs increased 6.1 percent and imports of consumer goods increased 3.1 percent. The increases took place despite several negative factors: political uncertainty, lack of confidence among entrepreneurs, slow GDP growth, a poor peanut crop, and high real interest rates.

With the liberalization of import controls and the reduction in tariffs, program designers expected the total volume of imports and customs revenues to increase. Instead, customs revenues declined. Part of the reason for the decline was a shift in the mix of imports toward goods with a lower tax rate. Even more important was an increase in customs fraud through "underinvoicing."

In August 1989, as a result of the precipitous decline in customs receipts, the Government reversed the process of customs liberalization and raised import duties. These measures reversed most of the reforms started 3 years earlier.

Even though the reforms lasted only 3 years, the evaluation found some limited impacts. Tariff reductions and import liberalization contributed to greater price stability. More imports, and cheaper imports, were part of the reason that the cost of living index declined sharply during the reform period.

Probably the most important aspect of the import reforms was the psychoeconomic shock the Government administered to the formal industrial sector. With a greater quantity of lower cost imports available, Senegalese firms had to scramble to find ways to reduce costs and improve marketing. In the absence of comfortable protective barriers, some firms were compelled to improve their internal efficiency but many were unable to adjust and restructure. Those unable to adjust had to cut back production or go out of business.

The evaluation found that a sizable number of formal sector firms failed and approximately 10,000 jobs were lost. Given the excess capacity of many of Senegal's high-cost firms, such losses were to be expected. Formal sector firms clearly suffered, but, based on A.I.D.-funded surveys, the informal sector appeared to have prospered from the reforms. An A.I.D. survey found that in the informal sector profits were up substantially, investment had increased, and most firms had increased their employment. In Dakar alone, approximately 17,000 new jobs opened in the informal sector, more than replacing the jobs lost in the formal sector. Nevertheless, many individuals suffered because they were unable to gain an informal sector job to replace the job they lost in the formal sector.

Income tax reform. A.I.D. provided technical assistance to help the Government revise the general tax code. The tax reforms were implemented, but only a short time before the evaluation. Although it is too early to measure the impact of these measures, the evaluation determined that the introduction of withholding tax on salaries, improvements in taxpayer identification, the establishment of an urban real estate register, and automation of the tax system should broaden the tax base and increase government revenues.

2.5.4 Factors Influencing the Performance of Policy Reforms

Related supporting reforms. The Government failed to implement complementary reforms, which greatly harmed the A.I.D.-supported industrial reforms. The complementary measures included reducing the cost of critical inputs (e.g., water, energy, communications, transportation, ports, and labor); providing additional flexibility in labor legislation associated with hiring, firing, and compensating workers; providing access to investment credit; and reducing the cost of administrative formalities. Without these complementary reforms, the A.I.D.-supported reforms were not fully effective.

Differing donor agendas. Despite apparent agreement among donors over the general framework for industrial sector policy reform, considerable differences surfaced among them during the implementation of the reforms. In some cases other donor programs went counter to the industrial sector reforms. The IMF, concerned about the Government's budget deficit, encouraged the Government of Senegal to increase import tariffs, which ran counter to the A.I.D.-supported reform of reducing tariffs. The French Government was anxious about the fate of French-owned (or operated) businesses, many of whose fortunes suffered from industrial sector liberalization. The donors were able to agree on broad general principles but actual implementation was not always mutually supportive.

Monitoring policy change. Although much data were collected, it was usually incomplete and inconsistent. The lack of a simple but effective monitoring system made measuring reform impacts difficult.

Psychoeconomic shock treatment. Although strategic care in the design of the implementation process is important, calculated dramatic shocks can also be used to maximum educational effect. For formal sector entrepreneurs, labor union leaders, investors, and government bureaucrats, the shock of change was important. After decades of protection, they had to adjust to conditions of world market competition. The informal sector, which was the most flexible in adapting to the changes, appears to be a major beneficiary of the reforms.

2.6 Uganda

2.6.1 The Economic Problems

Uganda relies on coffee exports for nearly all of its foreign exchange earnings. It must therefore diversify and expand its other exports to reduce its reliance on coffee and expand its sources of foreign exchange.

By the late 1980s, after nearly 20 years of political and military instability and near civil war, much of Uganda's infrastructure was destroyed and the economy was at a virtual standstill. Although donors funded the start of the reconstruction process, Uganda needed to increase its own export earnings if recovery was to be sustained. But coffee, which generated 95 percent of Uganda's foreign exchange earnings, could not produce the additional foreign exchange: coffee prices were down and the growth in world demand was slow. Uganda thus needed to increase exports of nontraditional (noncoffee) crops in order to increase its foreign exchange earnings.

In addition to the large and daunting physical problems of restarting production, developing new export crops, rebuilding highways and railroads, and developing marketing systems, several impediments hindered Uganda's recovery.

The official exchange rate was grossly

overvalued.

The private sector was not permitted to export most commodities.

Parastatals controlled much of the internal trade and nearly all external trade.

The Government was heavily involved in barter trade, with the terms of trade usually stacked against Uganda.

Exporters lacked necessary imports for preparing, processing, and packaging goods for export.

2.6.2 A.I.D. Policy Reform Objectives

The A.I.D.-supported reforms were designed to diversify foreign exchange earnings.

The shift to new exports was designed around a set of policies that provided private sector incentives for exporting nontraditional commodities. Two main parts defined the policy reforms: support of macroeconomic stabilization and restructuring policies, particularly those that encourage the establishment of competitive, market-oriented foreign exchange rates, and the development of specific trade-related policies to encourage nontraditional exports.

2.6.3 The A.I.D.-Supported Policy Reforms

Beginning in 1987, the Government of Uganda initiated a series of policy reforms supported by A.I.D., the World Bank, the IMF, and other donors. A.I.D. policy reform conditionality, under a commodity import program (CIP) and PL 480 assistance, included a number of reforms designed to encourage private sector, nontraditional (noncoffee) exports. The A.I.D.-supported reforms focused on devaluing the exchange rate, streamlining the export/import licensing process, and implementing measures to encourage nontraditional exports. The total reform package and the results of the reforms are summarized below:

Exchange rate adjustment. Over a 4-year period, the official rate for the Ugandan Shilling was steadily devalued and moved ever closer to the parallel rate.

Simultaneous export/import licensing. As an interim measure to encourage exports, an A.I.D. condition required the Government to provide exporters of nontraditional crops with an import license equal to the value of their exports. Any disadvantage exporters suffered from exporting at the official exchange rate was balanced by their ability to import scarce goods at the official rate. This measure gave an immediate boost to nontraditional exports.

Foreign exchange retention accounts. The option of foreign exchange retention accounts allowed exporters to hold onto their foreign exchange earnings. At a later date they could use the foreign exchange to import goods or to sell it on the parallel market at the premium rate. Exporters feared inflation and devaluation, so, to avoid those risks, they kept a portion of their earnings in foreign exchange.

Parastatal control of the export trade. The Government steadily abolished parastatal export monopolies, which allowed the private sector to export an expanding list of commodities.

Trade regulations and procedures. A.I.D. conditionality called for a reduction of the excessive bureaucratic procedures and fees for both export and import licenses. An exporter's "one stop" window was created, and exporters were given broad export certificates, without limits on volume. These reforms helped reduce the cost and time exporters spent meeting government procedural requirements.

Export of horticulture crops. In order to encourage exports of fruits and vegetables by airfreight, A.I.D. conditionality specified in the PL 480 assistance agreement called for a reduction in airport handling fees and royalties and the development of cold storage export facilities at the airport. Because these reforms are just being implemented, their impact cannot be measured until later.

Parallel foreign exchange market. The Government was encouraged to condone and then legalize the parallel market where foreign exchange trades at free market rates. Nearly all noncoffee exports now earn the parallel rate, and most private sector imports pay the parallel rate.

In addition to the immediate policy reforms, Uganda needed an indigenous capability for formulating and monitoring economic policy. The Government needed a capability to analyze data and to examine issues in order to develop a continuing series of policy reforms. To help the Government develop such a capability, A.I.D. technical assistance provided support for three functions: trade policy analysis, export promotion, and monitoring of the A.I.D.-supported policy reforms. A trade policy analysis and program monitoring unit was created in the Ministry of Planning and Economic Development. The unit helped develop a number of proposals to simplify export procedures and plays an important role in the reform process.

Early indications show strong and rapid growth in nontraditional exports as the Government continues to expand its reform efforts:

> The value of nontraditional exports appears to have risen by a factor of at least five during the 2-year reform period.
>
> The dual licensing scheme originally instituted under the program, and the subsequent foreign exchange retention accounts, paved the way for the convergence of the official and parallel foreign exchange regimes.
>
> The A.I.D.-supported policy analysis unit gained credibility as a major trade adviser to both the Government and A.I.D.

Government policymakers now view the indigenous private sector as the prime mover of the economic revival -- a key achievement since an important part of the reform process is convincing the Government that the private sector can play an important role in development. New export opportunities and improved investment prospects appear to have instilled new confidence in the private sector. One indicator is the fact that savings deposits have doubled, in real terms, during the last year in response to a series of reform measures that have brought inflation under control and liberalized interest rates. With positive real interest rates people are now more willing to hold financial assets. Another indicator is a residential and commercial construction boom, which reflects the fact that individuals and firms are now more confident. The private sector is still hesitant and uncertain about future prospects. Consequently, business investment, particularly longer term capital investment, is still meager.

2.6.4 Factors Influencing the Performance of Policy Reforms

> Physical infrastructure is critical. The years of political and economic turmoil had greatly damaged Uganda's transport system, and many regions were isolated. In the last 3 years, most of the railroads and main roads have been rebuilt. Areas of the country that were completely cut off are now accessible. Clearly, policies are important, but if the physical infrastructure is lacking, the results will be minimal. The road and rail rebuilding program has been a major reason

for the growth in the country's nontraditional exports. In Uganda, good infrastructure has been as important to export growth as good policies have been.

Marketing systems and business infrastructure are crucial to sustainable policy reforms. The private sector proved able to take advantage of market opportunities offered by the new policy reforms to turn a quick, speculative profit. Sustainable market and business relationships, however, are taking longer to build. Despite the many improvements generated by the reforms, the business environment remains constrained by excessive government regulations and bureaucratic procedures. Businesses need a supportive market system and business infrastructure to encourage longer term investments.

The link to policy change rather than the type or modality of assistance is the critical factor in an effective reform program. The impact of the reforms was dependent on the Government's ability to successfully adopt and implement the new policies. The type of assistance provided, that is CIP and PL 480 commodities, made little difference to the program's outcome. A.I.D. assistance could have been provided in the form of a loan or a grant, cash disbursement, CIP, or even project assistance. Well-conceived and well-implemented policies are critical to success; the type or form of policy-based assistance is not the critical factor.

Policy change that can reassure skeptical government officials has a demonstration effect. In Uganda, as in many developing countries, some government officials were not fully convinced at the program's inception of the value of free markets and private-sector-led growth. The program used a series or sequence of reforms to demonstrate how the private sector responds to higher foreign exchange rates and to greater participation in production, marketing, and exports. As a result of the demonstration effect, government officials were uniformly impressed with the performance of the private sector and willing to continue to expands its role. Developing country governments do not always recognize the value of a strong private sector. A demonstration or education effort may be needed.

Start with limited policy objectives that can be achieved in a short time period. The Uganda policy reform program faced a vast array of problems, but as a tactical measure A.I.D.

focused on a limited number of issues related to nontraditional exports. It makes sense to start with modest reforms that concentrate on a manageable task. As the program develops, complementary reforms can be added.

A sustained capacity for policy analysis supports the reform process. In order to support the policy reform process with a constant flow of empirical analysis, A.I.D. provided technical assistance to help the Government develop its own policy analysis unit. This unit produced several studies that helped direct the policy discussion and debate and greatly helped the reform process. An indigenous policy analysis capacity helps support sustainable reforms.

Adequate data collection and monitoring are a must if benefits are to be fully measured. The A.I.D. program design document called for detailed and extensive data collection, monitoring, and reporting -- requirements that were never achieved. As a result the magnitude and impacts of the reforms that have been launched are not very clear. Policy reform programs must put in place a doable data-collection system that relies on simple indicators and an analytical capacity to analyze the data.

Foreign exchange subsidies should be avoided. Throughout the Uganda program A.I.D. provided foreign exchange resources at the official exchange rate. The parallel rate was always much higher. Importers were therefore eager to receive A.I.D. funds since imports were scarce and importers would be receiving cheap foreign exchange. Since A.I.D. is interested in encouraging efficient allocation of resources, it should not be providing subsidized A.I.D.-funded resources.

Administrative allocation of the A.I.D. CIP sets a bad example. The USAID Mission decided on a case-by-case basis which commodities could be imported and which firms would receive CIP imports. Only a few importers were lucky enough to receive the cheap CIP imports; other importers had to pay the much higher free market rates. If A.I.D. wants to promote private sector growth and believes that governments should "let the market decide resource allocations," then it should not price CIP imports below the market rate and should not be involved in detailed commodity selection and allocations.

3. A Synthesis of Reform Results and Lessons Learned

The six country case studies cover a broad range of problems and a number of policy reform approaches. Within this diversity, however, a number of cross-cutting problems and common solutions are evident. This section examines the findings of the country studies and presents a set of common findings and lessons for A.I.D. planners. Box 2 lists some of the key policy findings and lessons identified in the country studies.

3.1 Price and Market Controls

3.1.1 Findings

The removal of price and market controls generally had an immediate and positive impact. In some cases, however, the private sector was hesitant or reluctant to take full advantage of new investment and market opportunities.

In Mali, contrary to expectations, the removal of price controls did not result in a rise in prices. Rather, decontrol reduced the substantial costs to retailers subject to arbitrary fines, or just plain shakedowns. The evaluation found that businesses had previously built in higher profit margins to pay the fines and bribes required under the old price control system. With the elimination of the uncertainty, bribes, and fines, businesses could operate at lower markups, which meant lower prices for customers. The anticipated social cost of price decontrol, routinely anticipated by those unfamiliar with the true cost of supporting an economic police force (price controllers), became a social benefit.

In Cameroon market controls were lifted, which ended the Government's fertilizer monopoly, and the private sector was allowed to import and distribute fertilizer. The reform resulted in an immediate and steep drop in the cost of importing and delivering fertilizer to farmers. The private sector was able to do the job at a much lower cost than the public monopoly, which suffered from corruption and inefficiency. In the first 2 years, the Government was able to save $14 million through lower subsidy payments and farmers were shielded from undue price increases.

In The Gambia the story was different; decontrol was not immediately successful. The government cooperative had received an agricultural marketing (or buying) allowance from the government parastatal that was substantially higher than the allowance given to private traders. The policy reforms equalized the allowances for both public and private traders, which should have made the private and government traders compete on an even basis. However, because the groundnut buying allowances were set too low, private traders could not cover the cost of doing business. The government cooperative did not have to cover costs or even make a profit; it simply went further into debt and failed to pay its bank loans. The few private traders who did test the market were badly squeezed and did not benefit from the reforms. The idea of letting private traders compete with a government cooperative only works if the government agency plays by the rules of the marketplace.

The Gambian financial and agricultural market reforms were designed to encourage investment, particularly in the agriculture sector. However, with an uncertain political and economic environment investors put most of their money into short-term investments and inventories, with very little invested in the agriculture sector.

Box 2. Key Findings/Lessons From the Six Evaluations

Findings/Lessons	Mali	Gambia	Cameroon	Malawi	Senegal	Uganda
Decontrol of prices and markets is critical	X	X	X			X
Elimination of subsidies and protection spurs efficiency			X	X	X	
Reduction of trade controls and bureaucratic redtape is important	X			X	X	
Linked markets require linked reforms	X	X	X		X	
Improved tax administration can spur government revenue	X				X	
An indigenous capacity to policy analysis is important	X	X			X	X
A.I.D. overmanagement of the reform process can slow reforms		X			X	
A monitoring and evaluation plan is essential	X	X	X	X	X	X
Policy reform is staff intensive	X	X	X	X		
Longer time horizons are needed	X	X				
Lack of donor coordination is a problem		X		X	X	
The social costs of adjustment must be considered	X		X	X	X	
External problems can harm reform efforts	X	X	X		X	

The reforms in Uganda ended the export monopoly on noncoffee crops previously held by government parastatals. Exports increased substantially as the private sector was quick to enter the export trade. In just 2 years, the reforms generated a fivefold increase in noncoffee exports. However, as in The Gambia, the private sector is uncertain about the political and economic future and is reluctant to sink money into longer term business investments.

A review of the African policy reform cases has produced two very different hypotheses to explain the failure of the private sector to make longer term investments. One hypothesis maintains that private investors have grown so accustomed to a rapacious bureaucracy, policy flip-flops, and political instability that they have become cynical about any apparent reform. Thus, they continue moving their capital abroad or engage only in short-term, relatively high-return investment. The other hypothesis claims that although incentive structures have improved, public infrastructure and other public goods needed to create profitable private investment opportunities are severely lacking in these countries. More likely in most developing countries a blend of both hypotheses applies, with one being dominant. Other factors, for example, lack of credit and lack of information about market opportunities, also impede longer term private investment.

The question, however, is which hypothesis is dominant in a particular case. If the first is dominant, foreign assistance can probably do little to restore private investor confidence in the short run. However, if the second hypothesis is correct, a foreign donor can do a great deal. Moreover, donors can accomplish much by helping governments to get out of production activities better left to the private sector and to allocate their resources to the provision of public goods to improve the business climate.

Despite the critical importance of public infrastructure and public goods, the fundamental factor influencing business confidence is a proper policy setting. This fact is the key lesson of the last 15 years. The policy environment must improve if businesses are to have the confidence to invest and increase their level of activity.

3.1.2 Lessons for A.I.D.

Price and market controls are not like government subsidies; they do not require an outlay of public funds and can stay in place for a long time since they seem to be cost-free. The evaluations found that once controls were lifted the benefits were clear. Only in The Gambia, where reforms were incomplete, was decontrol unsuccessful. A.I.D. should help developing country planners develop the analytical basis for examining controls and comparing domestic prices to international prices. Since agriculture is central to most developing country economies, getting those prices right is critical. Decontrol of key agricultural inputs and outputs should be high on the list of reforms.

3.2 Subsidies and Protected Markets

3.2.1 Findings

The elimination of subsidies and protection required some painful adjustments but proved to be a spur to productive efficiency. A reduction in government subsidies also meant reduced government expenditures.

In Senegal the reforms were designed to end years of industrial sector protection by opening markets and liberalizing imports. The results were dramatic: Prices for consumer and industrial goods declined as import competition brought prices down. Firms now faced competition and had to scramble to find ways to reduce costs and improve marketing. Many firms were unable to face the new competitive environment and had to cut back production or go out of business. Formal sector firms clearly suffered, but based on A.I.D.-funded surveys, the informal sector appears to have prospered from the reforms as informal sector profits, employment, and output expanded. In fact, informal sector employment appears to have expanded by 17,000 while formal sector employment declined by 10,000.

In Malawi the reduction in fertilizer subsidies clearly helped reduce government budget costs. Farmers' response to the reforms was a surprise, however. With the subsidy down and fertilizer prices up, farmers were expected to use fertilizer for higher value crops. Instead, the evaluation found that fertilizer use between crops had not changed. Fixed government procurement prices and restrictions on the type of crops grown influenced farmers' responses more than the fertilizer subsidy.

In Cameroon the reduction in the fertilizer subsidy also saved the Government money; however, in this case, the pattern of fertilizer usage on crops changed. Instead of putting fertilizer on high-value coffee trees, farmers used fertilizer for lower value food crops. The Government has kept its coffee purchase price low and has been slow (often a year or more in arrears) in paying farmers for their coffee production. As a result, farmers appear to be shifting fertilizer to noncoffee crops. As in Malawi, government procurement prices and policies turned out to be more important than the fertilizer subsidy.

3.2.2 Lessons for A.I.D.

The elimination of subsidies clearly means a savings for the developing country government budget. However, the reaction of firms and farmers to the changes can produce unexpected results. As the Malawi and Cameroon cases demonstrate, farmers can respond in rational, but unexpected ways. This experience suggests that before policy reforms are designed, A.I.D. should undertake more socioeconomic work with respect to the target population groups to identify other policies or factors that might counteract the olicy reform objectives.

3.3 Import and Export Controls

3.3.1 Findings

The removal of import and export controls in most cases improved efficiency but this measure was not always matched by a reduction in government bureaucratic regulations.

In Uganda government parastatals lost their monopoly control on noncoffee exports, private traders were allowed to export a wide range of products, and foreign exchange controls and pricing were liberalized. The results were impressive as private traders entered the field and sharply increased the export of nontraditional crops. Nontraditional exports increased fivefold in just 2 years. However, many bureaucratic and procedural requirements remained that made it costly and difficult for smaller firms to enter the export market.

In Mali import quotas were greatly reduced and then abolished. Automatic import licenses were issued for some 40 percent of imports and then expanded to cover nearly all imports. Export licensing was replaced by a simplified registration system. The immediate impact has been modest. Import procedures are still cumbersome, and the Government has added new antifraud measures to eliminate underinvoicing, measures that have tended to raise costs and create uncertainty for importers.

In Senegal the Government adopted a new customs code, substantially reduced quantitative restrictions on imports, and reduced tariffs. The removal of quotas and the liberalization of import licensing procedures allowed many new firms to import goods. Imports increased but only modestly, largely because of unfavorable economic conditions: slow GDP growth, political uncertainty, and high interest rates. The inflow of more imports and cheaper imports contributed to a decline in the cost-of-living index. However, businesses remained concerned about the burden of commercial reporting to numerous government offices.

3.3.2 Lessons for A.I.D.

Reduction in import and export controls produced clear benefits. However, in most cases, even after the controls were eliminated, a thicket of ministerial approvals, forms, and clearances remained, delaying and hindering traders. In each country A.I.D. must analyze not only the trade controls and taxes but also the bureaucratic hurdles that must be overcome. This effort may require extensive analysis of bureaucratic procedures and processes to identify all of the barnacles and the related cost in time and money to businesses. Consequently, bureaucratic hindrances must be taken into account when considering policy reforms.

3.4 Linked Markets and Linked Reforms

3.4.1 Findings

The elimination of government monopolies and controls opened markets and allowed the private sector to compete and deliver goods at lower cost. The problem of linked markets (where the government carried out reforms in one while still applying controls in a related market) often hampered reforms.

In The Gambia the Government allowed private traders to compete with the government cooperative in buying groundnuts from farmers. Although the agricultural output market (the sale of groundnuts) was opened to the private sector, the agricultural inputs market (fertilizer) was still a government monopoly. Since the farmers saw the two markets as linked, they feared the cooperative would refuse to sell them fertilizer if they sold their crop to private traders instead of the Cooperative. Thus, they were hesitant to deal with private traders. With one market decontrolled and the other still controlled, the reforms suffered.

The Cameroon program faced a similar problem. The Government opened the sale of agricultural inputs (fertilizer) to the private sector but maintained a monopoly on purchasing agricultural outputs (coffee). Facing a low price for coffee, farmers were reluctant to buy fertilizer for their coffee bushes, but they were willing to buy it for their food crops. The input and output markets were clearly linked, and the reforms in the input market were harmed by the lack of reforms in the output market.

In Senegal, industrial sector reforms included reduced import duties, liberalized import procedures, a new investment code, and a simplified and improved tax system. As noted in Section 3.2.1, the informal sector thrived under the reforms while the formal sector suffered. An important reason for the decline in the formal sector was the failure of the Government to implement complementary reforms in areas that were important to formal sector firms. The complementary reforms, which were part of the World Bank reform program, included reducing the cost of government-provided utilities, modifying labor laws, relaxing minimum wage laws, providing access to investment credit, and reducing government administrative formalities. Without these linked reforms, the reforms in the formal industrial sector could not be effective.

3.4.2 Lessons for A.I.D.

Before launching a policy reform program A.I.D. needs to perform more up-front analytical work to improve its understanding of the linkages and linkages of markets and policies. An effective monitoring and feedback system will help identify such linkages and allow corrections during the implementation period.

3.5 Tax Administration

A government will always face a revenue shortage if large-scale tax evasion is prevalent in the country or the tax-collection system is inefficient. In such cases, developing country governments can increase revenue by improving their tax administration.

In Mali reforms were designed to improve tax collections by automating income tax returns, improving the Customs Department's computer system, and strengthening tax enforcement. A key measure of improved tax administration is increased tax receipts. However, it is difficult to measure results in Mali, because many tax rates are being cut and the economy is depressed, factors that reduce tax receipts. Two taxes that were not cut, income and sales taxes, showed total revenue increases of 30 percent and 17 percent respectively between 1985 and 1988. Based on those increases and the fact that better legal enforcement was inducing more people to pay their taxes, the tax administration reforms were judged a success.

In Senegal a number of reforms were carried out: a revision of the general tax code, the introduction of withholding tax on salaries, improved taxpayer identification numbers, establishment of an urban real estate ledger, and automation of the tax system. The reforms have only been in place a short time, so it is too early to judge their success.

3.6 Indigenous Policy Reform Capability

3.6.1 Findings

A developing country with an internal capacity for policy analysis has the best prospects for sustaining policy reform over the long run. A.I.D. efforts to build an institutional capacity in several of the six countries should help future policy reform in those countries.

In Uganda A.I.D. helped the Government establish its own policy analysis unit. That unit was instrumental in surveying the legal and administrative impediments that were holding back exports. It produced analysis and studies that moved the policy debate successfully forward. The unit continues to gain stature and should prove to be a key player in future policy reform debate and implementation.

In The Gambia the technical assistance included in the original A.I.D. program was never provided. The lack of data analysis and technical advice may have contributed to the Government's failure to successfully implement some of the reforms.

In Senegal and Mali A.I.D. provided technical assistance to help in the design of the reforms and to collect data on the results of the reforms. However, no effort was made to institutionalize or continue an indigenous policy reform capability. This may prove to be a problem for future policy reform efforts.

3.6.2 Lessons for A.I.D.

Based on these limited experiences, some conclusions can be drawn. Each country faced serious structural problems that required economic reforms. A.I.D. and other donors worked with each developing government on the analysis and development of a package of reforms. Although the problems have been solved to varying degrees, in another year or two new problems will develop. Each developing country needs an indigenous capacity for analyzing the issues, guiding the debate, and leading the country toward a rational solution. The Uganda case shows how useful it is to have a local policy analysis institution. However, in other cases A.I.D. has not been as successful in developing a sustainable policy analysis capacity. As the findings discussed earlier demonstrate, A.I.D. policy reform design efforts are based on very tentative understanding of linkages, institutions, markets, and farmer behavior. In each country much that happened was unanticipated. Thus, programs need an ongoing analytical capacity to monitor and analyze preliminary results and feed that information into a redesign of the reform process.

3.7 A.I.D.'s Role in the Reform Process

3.7.1 Findings

A.I.D. Missions often become very heavily involved in the reform process. If the objective is to move toward private sector, market-based solutions, A.I.D. should not become part of a nonmarket resource allocation system.

In Cameroon the evaluation questioned the USAID Mission's heavy involvement in the management and implementation of the reforms. In particular, since the reforms were designed to privatize the fertilizer market, it seemed inappropriate for A.I.D. and the host government to be major players in the market. The continuation of managed markets, subsidies, and special access to credit delayed the movement to a free market. The evaluation argued that privatization would stand a better chance of success if the USAID Mission and the Cameroon Government withdrew from the market and allowed it to move quickly to a true free market.

The Mission disagrees with the evaluation findings and stresses the importance of creating free market institutions that will remain once market participants have mastered the requirements of competing in a free market. The Mission argues that the transition to a free market takes time and careful, phased management and direction by A.I.D. and the host government.

In Uganda the A.I.D. CIP provided foreign exchange resources at an exchange rate well below the parallel market rate. Since the A.I.D. resources were relatively cheap, the USAID Mission had to ration or allocate the resources. The Mission became involved in selecting eligible commodities and importers, often on a case-by-case basis. It would have been much better for the market to have allocated the resources.

3.7.2 Lessons for A.I.D.

In any movement to free markets, mistakes will be made as participants learn the rules of a new system. A.I.D. needs to determine how quickly the private sector can step in to replace the public sector in the procurement system and how to design the transition to a free market so that liberalization is not reversed. Only in exceptional cases should A.I.D. or the host government become involved in market decisions or allocations. A.I.D. should encourage rapid decontrol of markets. Managed markets with special subsidies and allocations create special interest groups who will oppose changes that threaten their privileged position. Consequently the process of reform and transition to free markets can become more difficult when those privileges are threatened.

3.8 Monitoring and Evaluation

3.8.1 Findings

Almost every evaluation noted a lack of policy monitoring and evaluation capability.

Nearly all of the evaluations found a similar set of difficulties relating to a lack of data-collection and analysis capabilities. Data are required by policy reformers in order to

- Understand the problems and their magnitudes
- Understand the process of policy change
- Measure success and plan for future efforts
- Provide in-depth analysis once data are available

While the reform measures were of a technical nature (prices, interest rates, subsidies), the results were not merely technical but affected economic and social interests as well. The reforms were designed to change the economic behavior of key groups and structural relationships within the economy. This meant differing impacts on different institutions, individuals, and interest groups. This political economy aspect of policy reform was critical to the success or failure of program efforts.

3.8.2 Lessons for A.I.D.

When planning reform programs, A.I.D. must consider the likely impact of the reforms on institutions and individuals. It should therefore build in a monitoring and impact assessment system that will help reformers respond to political-economy issues as the program is implemented. Similarly, when planning for data-collection and analysis, A.I.D. must recognize the difficulties prevalent in the data-poor environments of most African countries. In considering the likely impact of reforms on institutions and individuals, A.I.D. needs to define the impact variables that must be tracked, keep the monitoring system focused on those variables, and resist monitoring everything and collecting all available data to avoid creating stacks and stacks of unanalyzed data.

3.9 Social Analysis

The evaluations were weak in social analysis. They focused on the economic reform process and largely ignored the social impacts of reforms.

The evaluations expressed results in terms of economic aggregates, such as government revenues, tariff receipts, taxes, and trade. Only in a few cases were the impacts related to specific groups of people. One exception is Senegal, where the evaluation found that job growth in the informal sector more than matched the loss in formal sector jobs. Information of this kind makes the social dynamics of the policy reform process easier to understand.

Further, the evaluations had difficulty identifying the social and political tensions the reform process created and how those tensions worked to hinder or enhance the continuation of that process. Most of the evaluations presented policy reform negotiations and implementation as a dialogue between A.I.D. and the host government, ignoring the role of the powerful interest groups that had a stake in the reforms. Finally, the evaluations failed to differentiate reform impacts according to gender.

4. Findings and Lessons for the Future

4.1 Staff Requirements

4.1.1 Findings

Policy reform proved to be staff-intensive for both A.I.D. and host governments. Compared with traditional projects, the policy reform programs required more senior management time and attention during implementation and placed greater demands on professional staff for more sophisticated monitoring of the progress of policy reform implementation.

Before A.I.D. became involved in reform programs, conventional wisdom was that the heavy investment of staff resources would be up front during the analysis and negotiation stage of the reform program. Actual implementation would be relatively simple. However, according to the evaluations, A.I.D.'s experience demonstrates that the implementation of policy reforms is a complex process going far beyond the issuance of a government decree. Senior management from both A.I.D. and the host government must pay close attention to implementation issues if a reform program is to succeed. What's more, professional A.I.D. staff, such as the economist, the agricultural development officer, and others monitoring the progress of the policy reform program, must be alert to rear-guard actions, delaying tactics, and other subterfuges mounted, often in ways hidden from public view, by opponents of the reform.

In terms of staff resources, the fixed costs of policy reform programs are high and marginal costs are low. Thus, a $50 million program does not require double the management time of a $25 million program. This appears to be more true of policy reform than of project assistance.

4.1.2 Lessons for A.I.D.

When developing a policy reform program, A.I.D. must include the staff necessary for both up-front planning and analysis and the implementation period. A.I.D. must also consider the adequacy of host government management.

4.2 Longer Time Frame

4.2.1 Findings

It had been assumed that once an economic problem was identified and corrective action launched, things would be solved fairly quickly -- say in a year or two. The evaluations found that policy problems usually take more than 2 years to solve; problems tend to be more complicated than expected and linked with other problems. In addition, reform is a complicated process, with many layers that need analysis and correction.

4.2.2 Lessons for A.I.D.

A.I.D. should think of multiyear reform programs that may take 5 years or more to complete. In some cases a phased process would make the most sense. This would mean starting with a few manageable reforms, implementing them, and then tackling other reforms linked to those earlier efforts.

4.3 Donor Coordination

4.3.1 Findings

Every donor is in favor of improved donor coordination. However, agreements reached among donors at biannual donor consultative group meetings in Paris may not provide the answers to in-country implementation issues. Several of the evaluations found that donors had differing agendas and at times were pressing for inconsistent and conflicting policy changes.

4.3.2 Lessons for A.I.D.

A.I.D. needs to work closely with other donors at all stages of program development, design, and implementation.

4.4 Softening the Pain of Adjustment

4.4.1 Findings

Policy reform means economic adjustment and dislocations that generate social and personal costs. Mali was the only one of the six country programs that included specific measures designed to soften the adjustment process. The Mali program included a sizable reduction in civil service staff. A.I.D. helped displaced bureaucrats move to the private sector by funding business training courses, severance payments, and a new enterprise loan fund.

Although the social costs of adjustment are important considerations, in many cases the costs were limited and the benefits extensive. In Senegal many formal sector workers lost their jobs but a greater number of new jobs were created in the informal sector. In other cases those who lost income were unproductive officials, such as Cameroon's government bureaucrats who received kick-backs on fertilizer contracts and Mali's economic police who demanded bribes. In Senegal, long-established importers lost their privileged and protected positions when hordes of new importers entered the market. The elimination of such "fixers" or "rent seekers" should be recognized as a social good.

4.4.2 Lessons for A.I.D.

A.I.D. should include social analysis when planning policy reform programs to examine the assumptions about expected changes in the economic behavior of the target populations (e.g., farmers, entrepreneurs, traders). As part of the design of policy reform programs, A.I.D. should consider the costs of adjustment for those most severely affected by the reforms. A.I.D. also needs to recognize that many of the "reform losers" have been holding back economic productivity and their losses will be more than balanced by the gains of the "reform winners."

4.5 External Problems

4.5.1 Findings

In several cases the immediate reform measures were successfully implemented but problems in another area negated many of the reforms' successes. The evaluations found that the broader environment often produced unexpected problems: an overvalued exchange rate hurts export prospects; an economic slowdown and low domestic purchasing power can take the momentum out of the reforms; inappropriate controls and prices in another area can harm reforms; and inadequate physical infrastructure or markets can prevent the realization of production increases. In all of these cases policy problems in a related sector harmed the A.I.D.-supported reforms.

4.5.2 Lessons for A.I.D.

A.I.D. needs to keep its policy horizon broad to anticipate such problems.

This Synthesis is based on six country evaluations that were published in 1990 and 1991. The evaluations were sponsored by A.I.D.'s Center for Development Information and Evaluation and the Africa Bureau. Inquiries about the evaluations should be sent to the Center for Development Information and Evaluation, Agency for International Development, Washington, D.C. 20523-1802. The full titles and PN numbers (needed for ordering reports) of the six country evaluations are as follows:

The A.I.D. Economic Policy Reform Program in Mali, March 1990, A.I.D. Impact Evaluation Report No. 74, PN-AAX-236 (also available in French under order number PN-AAX-246).

The A.I.D. Economic Policy Reform Program in The Gambia, September 1990, A.I.D. Impact Evaluation Report No. 76, PN-AAX-241.

The A.I.D. Economic Policy Reform Program in Senegal, September 1990, A.I.D. Impact Evaluation Report No. 77, PN-AAX-242.

The Malawi Fertilizer Subsidy Reduction Program, December 1990, A.I.D. Evaluation Working Paper No. 143.

The A.I.D. Economic Policy Reform Program in Cameroon, June 1991, A.I.D. Impact Evaluation Report No. 78, PN-AAX-251.

The A.I.D. Economic Policy Reform Program in Uganda, December 1991, A.I.D. Impact Evaluation Report No. 79, PN-AAX-252.